Fig. 1A

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Fig. 2

Background and Relevance Check

What this Module *Is*

This module is designed to help you assess possible alternative deal structures for a proposed investment. By assessing your strategic, tactical, and operational priorities, the module will generate a preliminary list of applicable deal structures. Refining those recommendations with detailed analysis, the module will provide:

- evaluations of possible alternative deal structures,
- the logic behind any recommendations, and
- a high level quantitative analysis of the structuring alternatives.

What this Module Is *Not*

This module approaches deal structuring from a US GAAP (book) basis, and does not presently address any tax implications of possible structures. For detailed advice on these issues, please consult your professional services advisor.

Other Modules You Should Have Completed

Though not required, PortBlue highly recommends that you complete the following modules before beginning this module:

- M&A Strategy
- Target Identification
- Due Diligence
- Valuation

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Fig. 3

Lay of the Land / Required Materials

How this Module Works

This module asks a series of questions to determine potential deal structures for a given transaction. It proceeds with a series of high level questions to reach a preliminary recommendation of potential deal structures. To refine the preliminary results and isolate potential deal structures, users are then asked to complete a series of detailed analyses of four general categories:

- Business combinations (including purchase and pooling)
- Investments (including joint ventures, the cost method, the equity method, and the mark-to-market methods)
- Special-purpose entities
- Contractual arrangements

What You Need to Have

PortBlue recommends that you have the following materials available to you as you complete the module:

- Financial statements of the acquirer and target company
- Understanding of governance of the target entity (if applicable)
- Understanding of the expected inter-company transactions with target (if applicable)

Who Should Use This Module

This module was designed for use by the following individuals:

- Chief Financial Officer
- Chief Strategy Officer
- Comptroller/Accountant

Begin Module Assessments — 23

Fig. 4

Objectives Assessment 26

Every deal structure reflects a strategic objective

Background 30

To structure any successful transaction, you must begin with an assessment of the strategic objectives underpinning that deal. Presented below is a checklist that allows you to identify your strategic objectives. 28

Objectives Assessment Tool

31

Objective: What are you acquiring?	**Y**	**N**	**Cert.**
Entire business	X		
Intellectual property			
Human resources			
Distribution channel			
Product lines			
Manufacturing capacity			
Research capacity			
Access to capital			
Division or subsidiary			
Customers			
Cash flows			
Option / opportunity to purchase at a later date			
Good investment (buy to sell)			

	Value	**Certainty**
Expected Acquisition Price / Value	**X**	**(1-5)**

32

Proceed to next page 34

Fig. 5

Control Assessment

36

Your need for control affects the deal structure

Background 40

To understand the range of options available to your company, you must also understand the degree of control over the assets you desire after the transaction.

38

Control Assessment Tool

42

Strategic Objective	Unilateral Control	Shared Control	No Control (passive)
Entire business			
Intellectual property			
Human resources			
Distribution channel			
Product lines			
Manufacturing capacity			
Research capacity			
Access to capital			
Division or subsidiary			
Customers			
Cash flows			
Option / opportunity to purchase at a later date			
Good investment (buy to sell)			

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Fig. 6

Consideration: Planned Payment 50

What payment method do you plan to use in your investment?

Background 54

52 To understand the range of options available to your company, you must also determine how you plan to pay for your target in the transaction.

59

Consideration Assessment Tool

56 In the table below, please enter the dollar values of each form of consideration you will use in your investment, such that the total of the consideration equals the price of the investment.

58

Consideration	Value / Amount (if any)
Cash	
Debt	
Equity	
Property, plant, and equipment	
Intellectual property	
Human resources	
Other "soft" assets	

Total **ACQUISITION PRICE**

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FIG. 7

Measuring Success

55

How will you determine if your deal was successful?

Background

To understand the range of options available to your company, you must also understand the measures that you will use to judge if your transaction was successful.

Success Measurement Assessment Tool

56

Success Metric	Y	N	Cert.
Antidilution to EPS			
Operating income			
Tax incentives (NOLs, dividends)			
Return on assets			
Debt / equity ratio			

Proceed to preliminary recommendations

Fig. 8A

Preliminary Recommendation

Disclaimer

When looking at the potential deal structures below, please note that there may be specific factors unique to your situation that may cause a different structure to be more appropriate. PortBlue recommends that you refine your answers further before consulting with your professional services advisor.

65 66

64 **Potential Deal Structures (result of calculation)**

Deal Structure	Description (brief)	Applicability
Business Combination: Purchase	• Acquirer records identifiable assets and liabilities of target at "fair value" (including identifiable intangibles) • Excess of purchase price plus purchase expenses over fair value of identifiable net assets acquired is recorded as goodwill	
Business Combination: Pooling	• Financial statements for current and prior years are restated to retroactively combine the operations of the combining companies as if they always had been merged together • Assets and liabilities of combining companies continue to be recorded at historical cost (no step up in basis of assets or liabilities)	

62

Fig. 8B

Deal Structures Not Available (result of calculation)

Deal Structure	**Description (brief)**	**Reasons not suitable**
Investment: Corporate Joint venture	• Control and financial interest are equally shared by a small group of businesses in a separate and specific business or project for mutual benefit of the members. • Assets contributed to the venture are generally recorded at carry-over basis, resulting in no gain or loss for the contributor and improved earnings for the new entity.	
Investment: Equity Accounting Method	• Treated as partial-step acquisitions with the original investment recorded on the balance sheet at cost. • As the target earns income, the acquirer increases its investment in the target (balance sheet), as well as its own net income (income statement) by the acquirer's proportionate interest in the target's net income.	
Investment: Mark-to-Market Methods	• The accounting for a held investment depends on the type of security, its marketability and the intent of the holder.	
Investment: Cost Accounting Method	• The cost method is used for investments in non-marketable equity securities for which an investor has minimal or passive influence. • The investment is recorded on the balance sheet at cost, and maintained on the books as	

FIG. 8C

	such, except for dividends and impairment.	
Investment: Investment Company	• Must be Written	
Special Purpose Entity	• A leveraged financing approach (creating a separate entity) used to facilitate cost activities such as pharmaceutical / medical research or technological development	
Leveraged Buyout / Recapitalization	• An approach whereby debt and equity are used to pay out the majority of existing shareholders while maintaining purchase adjustments at the parent level. • Results in no step-up basis for target.	
Contractual Arrangements	• Must be written	

<u>Change Answers Above</u> 70

<u>Proceed to Detailed Analysis: Business Combinations</u>

Figure 9A

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Fig. 10

Business Combination Accounting

Background: Purchase vs. Pooling

66 Purchase and pooling methods of accounting are available when a business combination takes place. However, it is important to note that the pooling of interests method of accounting is *not an election*, but can only be used when 12 specific conditions are met. If all of the conditions are not met, then the business combination would be treated as a purchase.

Purchase Method: Accounting Implications

The purchase method assumes one organization acquires another:

68

- Acquirer records identifiable assets and liabilities of target at "fair value" (including identifiable intangibles)
- Excess of purchase price plus purchase expenses over fair value of identifiable net assets acquired is recorded as goodwill
- Direct expenses of the purchase are capitalized (acquiring entity)
- Negative goodwill
- Income statement includes operations of acquired company subsequent to acquisition date.

Pooling Method: Accounting Implications

The pooling method assumes that the two organizations have always been one entity:

70

- Assets and liabilities of combining companies continue to be recorded at historical cost (no step up in basis of assets or liabilities)
- Financial statements for current and prior years are restated to retroactively combine the operations of the combining companies as if they always had been merged together
- No adjustments are made to the financial statements except for intercompany balances and transactions
- Costs of pooling are charged to expense

see numerical examples 82

New FASB rulings

This section enumerates the state of the FASB rulings on the issue.
Which method applies to my situation?

86

Fig. 11

Required Materials

What You Need to Have

This section lists the materials necessary to complete the module meaningfully.

Who Should Complete this Module

It also recommends particular individuals who may want to contribute to the module.

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90

Fig. 12

Initial Questions

Is this a Business Combination?

To determine if the purchase method is appropriate, we must first determine if a business combination is taking place…

Combination Tool (must be written)

92

	Y	N
Questions to understand if this is a BC:		
Questions to understand if this is a BC:		

Which is the Acquiring Entity?

We must also determine which is the acquiring entity?

Acquiring Entity Tool (must be written)

94

	Y	N
Questions to understand which is acquiring entity:		
Questions to understand which is acquiring entity:		

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Fig. 13

Purchase vs. Pooling

Purchase vs. Pooling is *Not* an Election

The pooling of interests method of accounting is not an election, but can only be used when 12 specific conditions are met. If all of the conditions are not met, then the business combination must be treated as a purchase.

Disclaimer

This tool is designed to give you a preliminary indication of whether you might qualify for pooling accounting. It does not constitute professional advice, and you should confirm these results with your professional services advisor.

Pooling Assessment Tool

102

Attributes of Combining Enterprises	Y	N
Entities autonomous? (is one company a subsidiary of the other?)		
Entities independent? (greater than 10% cross-ownership?)		

104

Manner of Combining Interests	Y	N
Is the single transaction or plan completed in one year?		
Voting common-stock for voting common-stock?		
Changes in equity interests were not in contemplation?		
Absence of treasury stock transactions?		
Each shareholder treated equally / proportionately?		
Are any shareholders restricted or deprived of rights?		
Contingencies resolved?		

106

Absence of Planned Transactions	Y	N
Planned share repurchases?		
Are there any special financial arrangements?		
Planned dispositions of assets?		

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Fig. 14

Applying the Pooling Method

Pooling May Remain Available to You
Based on a preliminary assessment only, your transaction continues to qualify for use of the pooling method.

Applying the Pooling Method
The following tool will help you analyze what impact the planned business combination will have on your financial statements as a result of applying the pooling method

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Fig. 15

Pooling Method Application: Results

Impact on Financial Statements

113

	(from above)
	(from above)
	(calculated)
	(from above)
	(from above)
	(calculated)
	(calculated)

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Fig. 16

Applying the Purchase Method

Pooling Does Not Apply to Your Transaction

Based on a preliminary assessment only, your transaction does not qualify for pooling of interests for the following reasons:

115

- Reason 1
- Reason 2
- Reason 3

Applying the Purchase Method

The following tool will help you analyze what impact the planned business combination will have on your financial statements as a result of applying the purchase method.

Assessment Tool

116

Price paid for acquiree	(data entered)
Direct purchase costs	(data entered)
Identifiable assets @ FV	(data entered)
Identifiable liabilities @ FV	(data entered)

Proceed to next page

Fig. 17

Purchase Method Application: Results

(completed only if pooling not available & data entered above)

Allocating the Purchase Price

118

Price paid for acquiree	(from above)
Direct purchase costs	(from above)
Total purchase price	(calculated)
Identifiable assets @ FV	(from above)
Identifiable liabilities @ FV	(from above)
Identifiable net assets	(calculated)
Excess purchase price over net assets acquired (goodwill)	(calculated)

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Fig. 18

Appendices: Definitions

Acquiring Entity

- The acquiring entity is presumed to be the group of shareholders that receives the largest voting interest in the combined entity.
- The larger entity normally issues stock to acquire all of the voting interests of the smaller entity and retains the greatest share of voting interest after the transaction.

Business Combination

What is a business?

- A business consists of substantive operations
- Resolved ambiguity in existing rules for exchanges of "similar productive assets" and "businesses"

What is a combination?

- Occurs when a corporation and one or more businesses are brought together into one accounting entity. More than one legal entity may remain.
- The remaining, single entity carries on the activities (operations) of the previously separate, independent enterprises.
- Results in "consolidated financial statements" when the separate legal existence of an entity remains after the combination (subsidiaries)

Fig. 19

Business Combinations: Numerical Example

Assumptions for the Example

This example demonstrates the impact of the pooling vs. purchase methods on an acquirer's financial statements. It is based on the following assumptions:

- The Acquirer issues 5 million shares of common stock to acquire 100 percent of outstanding shares of the Target
- Fair value/quoted market price of Issuing Company is $10 per share
- Book value of Target's net assets is $10 million

Pooling Method Example

	Issuer	Target	Combined
Current assets	250	50	300
Depreciable assets	50	5	55
Intangible assets	20	0	20
Goodwill	0	0	0
Liabilities	(240)	(45)	(285)
Net Assets	80	10	90

Purchase Method Example

	Issuer	Target	Combined
Current assets	300	0	300
Depreciable assets	55	5	60
Intangible assets	20	10	30
Goodwill	0	20	20
Liabilities	(285)	5	(280)
Net Assets	90	40	130

Pooling vs. Purchase

	Pooling	Purchase	Difference
Current assets	300	300	0
Depreciable assets	55	60	(5)
Intangible assets	20	30	(10)
Goodwill	0	20	(20)
Liabilities	(285)	(280)	(5)
Net Assets	90	130	40

Fig. 20

Appendices: Recognition of Liabilities in Purchase Accounting

Exit Costs

- *Not* associated with future revenues
- *Not* incurred to generate revenues
- Have no future economic benefit
- Incremental
- Incurred as a direct result of plan to exit
- Represent contractual obligation
- Plan to exit activity of *acquired* company

Termination Benefits and Relocation Costs

- Acquired company employees only
- Plan of termination (relocation) with specific identification of number, classification, and location
- Communication of termination benefits to employees
- Plan completed in near term - changes not likely